South Carolina Law Review

Volume 30 | Issue 1 Article 11

1979

Miscellaneous

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MISCELLANEOUS

I. DISCIPLINARY PROCEDURE

A. Solicitation

On May 30, 1978, the United States Supreme Court set a significant precedent by reversing the South Carolina Supreme Court's decision in *In re Edna Smith Primus,*[1] an attorney disciplinary action. Along with its companion case, *Ohralik v. Ohio State Bar,*[2] *In re Primus* further defines the parameters of first and fourteenth amendment speech and associational protections afforded attorney communications with nonclients.

The disciplinary action brought against Mrs. Primus arose in the context of a civil action involving an Aiken, South Carolina, physician. In July 1973, Mrs. Primus, in her capacity as legal consultant for the South Carolina Counsel on Human Relations, met with Mrs. Marrietta Williams and other women to discuss their rights against Dr. Clovis Pierce, who had sterilized the women after allegedly threatening to withhold Medicaid benefits if they did not consent to the procedure. At this meeting they discussed the possibility of a class action suit against Dr. Pierce. Mrs. Williams later received a letter signed by Mrs. Primus. It said that the American Civil Liberties Union (ACLU) was interested in filing the lawsuit on her behalf.[3] As a result of the meeting with the potential plaintiffs and the subsequent letter sent to Mrs. Williams, suit was instituted against Dr. Pierce.[4]

After instigation of this litigation the South Carolina Board of Commissioners on Grievances and Discipline filed a complaint against Mrs. Primus and disciplinary proceedings began. The Board issued a private reprimand based on its finding that Mrs. Primus had violated the Code of Professional Responsibility.[5]

Mrs. Primus, in addition to her capacity as legal consultant to the South Carolina Council on Human Relations, was, at the time of the Pierce litigation, also an officer and cooperating attorney with the ACLU. In its findings of fact the Board held that

1. 436 U.S. 412 (1978).
2. 436 U.S. 447 (1978).
3. In re Smith, 268 S.C. 259, 262, 233 S.E.2d 301, 302 (1977).
4. *See* Walker v. Pierce, 560 F.2d 609 (4th Cir. 1977).
5. 268 S.C. at 269, 223 S.E.2d at 306. The South Carolina version of the Code of Professional Responsibility applied to appellant is the one as amended by the House of Delegates of the American Bar Association on February 24, 1970. *See* S.C. SUP. CT. R. 32 (Cum. Supp. 1977).

Mrs. Primus had solicited Mrs. Williams, if not on her own behalf, on behalf of the ACLU.[6] The Board also found that while the ACLU had formerly been reimbursed only from damages that might eventually be awarded plaintiffs in the cases the ACLU entered, it had begun to ask for fees in addition to and apart from damages.[7]

The Board thus considered Mrs. Primus' conduct a violation of the Code's Disciplinary Rule 2-104(A)(5),[8] which provides:

> (A) A lawyer who has given unsolicited advice to a layman that he should obtain counsel or take legal action shall not accept employment resulting from that advice, except that:
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> . . . .
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> (5) If success in asserting rights or defenses of his client in litigation in the nature of class action is dependent upon the joinder of others, a lawyer may accept, but shall not seek, employment from those contacted for the purpose of obtaining their joinder.

Moreover, Mrs. Primus' conduct was found to violate Disciplinary Rule 2-103(D)(5)(a) & (c)[9] providing:

> (D) A lawyer shall not knowingly assist a person or organization that recommends, furnishes, or pays for legal services to promote the use of his services or those of his partner or associates. However, he may cooperate in a dignified manner with legal service activities of any of the following . . . .
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> . . . .
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> (5) Any other non-profit organization that recommends, furnishes or pays for legal services to its members or beneficiaries, but only in those instances and to the extent that controlling constitutional interpretation at the time of the rendition of the service requires the allowance of such legal activities, and only if the following conditions, unless prohibited by such interpretations are met:
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> (a) The primary purposes of such organizations do not include the rendition of legal services.
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> . . . .
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> (c) Such organization does not derive a financial benefit from the rendition of legal services by the lawyer.

The South Carolina Supreme Court upheld the Board's find-

6. 268 S.C. at 263, 223 S.E.2d at 303.
7. *Id.*
8. S.C. SUP. CT. R. 32 (Cum. Supp. 1977).
9. *Id.*

ings,[10] but raised the private reprimand issued by the Board to a public reprimand.[11]

Mrs. Primus appealed to the United States Supreme Court, claiming that the first and fourteenth amendments protected the sort of solicitation she undertook. In stating her position, she relied on the rationale of a line of United States Supreme Court cases that began with *NAACP v. Button.*[12]

NAACP v. Button arose from the NAACP's challenge of Virginia's school segregation policies. The named individual plaintiffs were not members of the NAACP, but the NAACP contacted and advised them in a manner similar to the way Attorney Primus approached and counseled Mrs. Williams.[13] Staff attorneys of the NAACP in the Virginia litigation were paid from a fund set up by the organization for these purposes. The United States Supreme Court in *Button* reversed the Virginia Supreme Court's decision that had held that the activity was criminal solicitation under Virginia law.[14] The Supreme Court found that the first and fourteenth amendments protected the group arrangement utilized in *Button* and that Virginia could not constitutionally regulate it.[15] The Supreme Court later extended these first and fourteenth amendment protections to the legal aid plans of unions. Under these plans, union members with legal problems were referred to attorneys whom the unions had either hired[16] or approved.[17]

The drafters of the Code of Professional Responsibility attempted to lessen the impact of *Button* and its progeny by construing the cases narrowly and prohibiting any form of solicitation not explicitly protected.[18] Thus, *Primus* illustrates the conflict between the efforts of the organized bar to minimize solicitation by lawyers and the United States Supreme Court's attempts

10. 268 S.C. at 269, 223 S.E.2d at 306.

11. *Id.*

12. 371 U.S. 415 (1963).

13. *Compare* NAACP v. Button, 371 U.S. at 420-22, *with In re* Smith, 268 S.C. at 262, 233 S.E.2d at 302.

14. 371 U.S. at 442-45.

15. *Id.*

16. UMW v. Illinois State Bar Ass'n, 389 U.S. 217 (1967).

17. United Trans. Union v. State Bar of Mich., 401 U.S. 576 (1971); Brotherhood of Railroad Trainmen v. Virginia, 377 U.S. 1 (1964).

18. *See* Freedman, *Advertising and Solicitation by Lawyers: A Proposed Redraft of Canon 2 of the Code of Professional Responsibility,* 4 HOFSTRA L. REV. 183, 186 (1976); Note, *Advertising, Solicitation and the Profession's Duty to Make Legal Counsel Available,* 81 YALE L.J. 1181, 1186 (1971).

to constitutionally protect attorney solicitation, at least insofar as solicitation gives court access to people who would otherwise not have it.

In reversing the South Carolina Supreme Court's ruling, the Supreme Court of the United States held that South Carolina's application of the disciplinary rules to appellant Primus' conduct violated the first and fourteenth amendments.[19] Writing for the majority, Justice Powell relied on the *Button* principle that "collective activity undertaken to obtain meaningful access to the courts is a fundamental right within the protection of the First Amendment"[20] and held that "[f]or the ACLU, as well as for the NAACP, 'litigation is not a technique of resolving private differences'; it is 'a form of political expression' and 'political association.'"[21]

Justice Powell rejected the Board's attempted distinctions between *Button* and *In re Primus,* noting initially that it was nowhere seriously argued that Appellant herself had received any significant financial gain. As for the ACLU's alleged financial benefit, Justice Powell pointed out that even though the ACLU had begun to request awards of attorneys' fees, the fees went into a central fund similar to the fund in *Button,* that the NAACP also had made similar requests, and that at the time of the letter to Mrs. Williams, it was ACLU policy that no staff attorney should receive payment from damages obtained in the case.[22]

Because first amendment rights of political expression and association were at issue, Justice Powell stated that strict scrutiny principles applied.[23] He interpreted DR 2-103(D)(5) to be overly broad as applied. This was especially true because the State asserted in oral argument that if anyone in the ACLU were ultimately to be involved in the litigation, no one in the ACLU could communicate the willingness of the organization to handle the case without being guilty of solicitation — even if only legal advice had been given at the initial meeting with Mrs. Williams.[24] Moreover, Justice Powell perceived a danger of censorship

19. 436 U.S. at 439.

20. *Id.* at 426 (quoting Justice Black's summary of *Button* in United Trans. Union v. State Bar of Mich., 401 U.S. 576, 585 (1971)).

21. 436 U.S. at 428 (quoting *Button,* 371 U.S. at 429, 431).

22. 436 U.S. at 429, 430 n.24.

23. *Id.* at 432-33.

24. *Id.* at 433. *See also* Baker, *Do Lawyers Have a First Amendment Right to Solicit?,* 64 A.B.A.J. 364, 370 (1978).

through selective enforcement of the overly broad disciplinary rules.[25]

Justice Powell carefully distinguished the *Ohralik* case decided the same day. In that case, an Ohio lawyer had been suspended from practice for personally approaching an auto accident victim in her hospital room and offering to represent her.[26] Because the in-person solicitation in *Ohralik* had been for personal gain, the conduct described more nearly fit the traditional descriptions of champerty and maintenance. For that reason, *Ohralik* allowed a mere showing of potential danger by the state to suffice for it to be able legitimately to discipline the conduct.[27]

In the one dissenting opinion in *Primus,* Justice Rehnquist stated that the disciplined conduct in *Ohralik* and *Primus* was essentially the same; that is, uninvited solicitation:

> Neither *Button* nor any other decision of this Court compels a state to permit an attorney to engage in uninvited solicitation on an individual basis. Further, I agree with the Court's statement in the companion case *Ohralik* that the State has a strong interest in forestalling the evils that result "when a lawyer, a professional trained in the art of persuasion, personally solicits an unsophisticated, injured or distressed lay person."[28]

Justice Rehnquist further distinguished *Button* by noting that the staff lawyers of the NAACP had played a limited role in the solicitation and also that Virginia had not instituted suit against the individual lawyers.[29] The majority expressly rejected this narrow reading.[30]

Justice Rehnquist also pointed out that an overzealous civil liberties attorney might be just as dangerous to the best interests of the potential plaintiff as an attorney who stirs up litigation for his own financial gain.[31] This same consideration, however, would seemingly have applied in *Button;* yet the Court did not find it weighty enough to allow state intervention in the area of protected rights of expression and association.

The ultimate precedential value of *In re Primus* is difficult to predict because the American Bar Association revised the Code

25. 436 U.S. at 432-33.
26. Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 452-54 (1978).
27. *In re* Primus, 436 U.S. at 422, 438-39.
28. *Id.* at 441.
29. *Id.* at 444 n.3.
30. *Id.* at 425 n.16.
31. *Id.* at 445-46.

while *Primus* was being litigated.[32] Although the South Carolina

32. ABA, SUMMARY OF ACTION OF THE HOUSE OF DELEGATES 4 (1975 Midyear Meeting). Disciplinary Rule 2-103(D)(4) was amended to the following form:

> (D) A lawyer shall not knowingly assist a person or organization that furnishes or pays for legal services to others to promote the use of his services or those of his partner or associate or any other lawyer affiliated with him or his firm except as permitted in DR 2-101(B) [permitting dignified identification of the lawyer as a lawyer in certain circumstances, as in political advertisements, in public notices required by law, and in legal documents]. However, this does not prohibit a lawyer or his partner or associate or any other lawyer affiliated with him or his firm from being recommended, employed or paid by, or cooperating with, one of the following offices or organizations that promote the use of his services or those of his partner or associate or any other lawyer affiliated with him or his firm if there is not interference with the exercise of independent, professional judgment in behalf of his client:
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> . . . .
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> (4) Any bona fide organization that recommends, furnishes or pays for legal services to its members or beneficiaries, provided the following conditions are satisfied:
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> (a) Such organization, including any affiliate, is so organized and operated that no profit is derived by it from the rendition of legal services by lawyers, and that, if the organization is organized for profit, the legal services are not rendered by lawyers employed, directed, supervised, or selected by it except in connection with matters where such organization bears ultimate liability of its member or beneficiary.
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> (b) Neither the lawyer, nor his partner, nor associate, nor any other lawyer affiliated with him or his firm, nor any other non-lawyer, shall have initiated or promoted such organization for the primary purpose of providing financial or other benefit to such lawyer, partner, associate or affiliated lawyer.
>
> (c) Such organization is not operated for the purpose of procuring legal work or financial benefit for any lawyer as a private practitioner outside of the legal services program of the organization.
>
> (d) The member or beneficiary to whom the legal services are furnished, and not such organization, is recognized as the client of the lawyer in the matter.
>
> (e) Any member or beneficiary who is entitled to have legal services furnished or paid for by the organization may, if such member or beneficiary so desires, select counsel other than that furnished, selected or approved by the organization for the particular matter involved; and the legal service plan of such organization provides appropriate relief for any member or beneficiary who asserts a claim that representation by counsel furnished, selected or approved would be unethical, improper, or inadequate under the circumstances of the matter involved and the plan provides an appropriate procedure for seeking such relief.
>
> (f) The lawyer does not know or have cause to know that such organization is in violation of applicable laws, rules of court and other legal requirements that govern its legal services operations.
>
> (g) Such organization has filed with the appropriate disciplinary authority at least annually a report with respect to its legal services plan, if any, showing its terms, schedule of benefits, its subscription charges, agreements with counsel, and financial results of its legal service activi-

Supreme Court has not adopted the revisions of the Code, several states have.[33] The revisions of DR 2-103 might have permitted solicitation of the kind engaged in by appellant Primus if they had applied at the time. The revisions provide that an attorney may assist an organization that pays for legal services to its beneficiaries so long as neither the attorney nor the organization has the generation of a profit as its primary purpose in rendering the services and so long as the beneficiaries of the services are recognized as clients who are free to seek legal services from other sources.[34] The trend of judicial decision[35] and the criticism of various commentators[36] prompted the revisions.

The United States Supreme Court established in *Ohralik* and *Primus* that while states may regulate and discipline attorney solicitation traditionally associated with champerty and maintenance, they may not regulate or discipline solicitation undertaken merely to give litigants meaningful access to the courts. The Court has decisively rejected a narrow reading of *Button.* Notwithstanding apparent difficulties in differentiating prohibited from protected solicitation and Justice Rehnquist's fear that ambulance-chasing lawyers will henceforth claim the constitutional protections of political association in disciplinary proceedings against them, the key concepts in distinguishing

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ties or, if it has failed to do so, the lawyer does not know or have cause to know of such failure.

Id. at 4-7.

The Code was amended again in 1977. See ABA CODE OF PROFESSIONAL RESPONSIBILITY AMENDMENTS, 46 U.S.L.W. 1 (Aug. 23, 1977), wherein DR 2-103(D) was amended to read:

(D) A lawyer or his partner or associate or any other lawyer affiliated with him or his firm may cooperate with, one of the following offices or organizations that promote the use of his services or those of his partner or associate or any other lawyer affiliated with him or his firm if there is no interference with the exercise of independent professional judgment on behalf of his client.

The revision merely restates what is permitted in the 1975 version without stating it as an exception to what is prohibited. Because subsections (4)(a)-(g) were readopted verbatim, the 1977 revisions did not significantly change the 1975 revisions.

33. NEW YORK JUD. LAW app. DR 2-103 (Cum. Supp. 1976) (McKinney) recognizes the 1976 revisions of the Code. Several states have adopted the 1977 revisions. *See* GA. CODE ANN. tit. 9 app. at 51, 55-56 (Cum. Supp. 1978); 42 PA. CONS. STAT. ANN. Code of Professional Responsibility DR 2-103 (Cum. Supp. 1977) (Purdon); R.I. GEN. LAWS Sup. Ct. Rule 47, DR 2-103 (Cum. Supp. 1977). *See also* KY. REV. STAT. § 18 RAP 3.130 (Cum. Supp. 1977) (adopting 1977 revisions by implication).

34. *See* note 32 *supra.*

35. *See generally* discussion accompanying notes 12-17 *supra; see also* Bates v. State Bar of Arizona, 433 U.S. 350 (1977).

36. *See generally* articles cited in note 18 *supra; see also Attorney Advertising: Bates' Impact on Regulation,* 29 S.C.L. REV. 457, 463-77 (1978).

Ohralik from *Primus* seem to be group association and, from the attorney's standpoint, personal gain. The presence of the former and the absence of the latter suggest that the danger to the public and the courts will be minimal. Hence, the Code's purpose of making legal services available will be advanced in a meaningful way.

B. Attorney Misconduct Unrelated to the Practice of Law

The South Carolina Supreme Court decided two cases in 1977 in which disciplinary action was taken against attorneys for misconduct outside of their professional capacities. The two cases, *In re McDonald,*[37] and *In re Boineau,*[38] seem very similar, yet in disposing of them, the court reached different results. Respondent in *In re McDonald* had pleaded guilty to two separate incidents involving lascivious conduct with children. The Board filed a complaint alleging that the crimes involved moral turpitude and, therefore, constitute "misconduct" as defined by Rule 4(c) of the Rules of Disciplinary Procedure.[39] Respondent did not contest the complaint, but asked the supreme court to accept his tender of resignation from the South Carolina Bar. The Board also recommended acceptance of respondent's resignation. A majority of the court, however, found that the admitted conduct warranted permanent disbarment.[40] In *Boineau,* on the other hand, respondent's real estate broker's license had been revoked because of dishonest conduct in his activities as a broker.[41] The Board's complaint recommended disbarment, but the supreme court granted respondent's prayer that he be allowed to resign.[42]

It has been long recognized that a lawyer might be disciplined for conduct unrelated to the practice of law.[43] While the South Carolina Supreme Court did not directly address the issue until this year,[44] the court noted in dicta in respondent Boineau's

37. 269 S.C. 598, 239 S.E.2d 83 (1977).

38. 269 S.C. 189, 236 S.E.2d 821 (1977).

39. S.C. Sup. Ct. R., Att'y Discip. P. § 4(c) (1976).

40. 269 S.C. at 599, 239 S.E.2d at 83.

41. The conduct referred to includes various instances of fraud. South Carolina Real Estate Comm'n. v. Boineau, 267 S.C. 574, 230 S.E.2d 440 (1976).

42. 269 S.C. at 190, 236 S.E.2d at 822.

43. *See* S.C. Sup. Ct. R. 32, DR 1-102(A).

44. *See In re* Martin, 264 S.C. 1, 212 S.E.2d 251 (1974) (court indefinitely suspended attorney after conviction for failure to file federal tax return, but without discussing fact that conduct was unrelated to practice of law).

1976 appeal from the revocation of his broker's license that disciplinary proceedings are appropriate in such a case.[45] Moreover, the language of section 4(d) of the Rules of Disciplinary Procedure broadly prohibits misconduct in general, while leaving the definition of what constitutes misconduct to the Board and the supreme court.[46]

Practically the results of *McDonald* and *Boineau* are identical, because it is highly unlikely that either respondent will be allowed to practice law in South Carolina again. The difference in the treatment of the two cases is that respondent Boineau was allowed to avoid the stigma of disbarment. Perhaps the reason the court administered the more stringent penalty in *McDonald* can be understood by examining the nature of the conduct involved in the two cases. In *McDonald,* the conduct involved moral turpitude, a term not given precise definition, but used to describe acts that are themselves immoral without regard to whether criminal sanction may be imposed for the particular act.[47] The conduct involved in *McDonald* is criminal in nature, and respondent received a prison sentence. The fraudulent conduct described in *Boineau* is not clearly criminal; although it could conceivably be punished by imprisonment,[48] apparently such proceedings were not instituted.

The primary purpose of disbarment is to protect the court and the public, not to punish the attorney.[49] Because the appearance of impropriety and the danger to the courts and the public are considered more important than strict interpretations of whether the conduct is criminal,[50] there seems to be no readily apparent policy reason for the different treatment of these two cases. The commission of fraud and deceit in financial matters impunes an attorney's fitness to practice law no less than the commission of lewd acts. The court emphasized in *Boineau* that while respondent was a member of the bar, he had never held himself out as a lawyer or practiced law.[51] Therefore, the need to protect the public from an attorney's malfeasance in *Boineau* was lessened. This factor, however, hardly distinguishes these two cases enough to justify imposing two different penalties, because

45. 267 S.C. at 579, 230 S.E.2d at 442.
46. S.C. SUP. CT. R., ATT'Y DISCIP. P. § 4(d)(1976).
47. Pippin v. State, 197 Ala. 613, 616, 73 So. 340, 342 (1916).
48. *See* S.C. CODE ANN. § 27-23-30 (1976).
49. State v. Jennings, 161 S.C. 263, 266, 159 S.E. 627, 629 (1931).
50. *Cf.* Burns v. Clayton, 237 S.C. 316, 334, 117 S.E.2d 300, 309 (1960).
51. 269 S.C. at 190, 236 S.E.2d at 822 (1977).

McDonald, like Boineau, asked that his permanent resignation be accepted. Resignation would protect the public and the courts as well as would disbarment. Moreover, as Justice Gregory noted in dissent in *McDonald,* respondent had practiced only briefly and his conduct was wholly divorced from the practice of law.[52]

In the aftermath of the Watergate scandal, a flood of public light was focused on the legal profession. This apparently brought about a willingness on the part of the bench and the bar in various jurisdictions to scrutinize more closely the extralegal conduct of attorneys. Indeed, several states have directly instituted disciplinary proceedings against attorneys implicated in misconduct connected with President Nixon's re-election in 1972.[53] This more exacting scrutiny has not been reserved for politically motivated misconduct, however, and in the last several years the number of cases in which lawyers were disciplined for conduct outside of the practice of law has grown.[54] The courts recognize that an attorney's duty to behave honestly and morally is greater than that of the layman, because of the attorney's position of public trust.[55] South Carolina seems to be following this trend of heightened scrutiny of attorney behavior.

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52. 269 S.C. at 599, 239 S.E.2d at 83 (1977).

53. *See, e.g.,* Segretti v. State Bar, 15 Cal. 3d 878, 544 P.2d 929, 126 Cal. Rptr. (1976) (attorney disciplined for covert, deceitful activities designed to confuse candidates of opposition party); State *ex rel* Neb. State Bar Ass'n v. Cook, 194 Neb. 364, 232 N.W.2d 120 (1975) (attorney disciplined for giving perjured testimony in the trial of Mitchell and Maurice Stans); *In re* Nixon, 53 A.D.2d 178, 385 N.Y.S.2d 305 (1976) (attorney disciplined for various instances of obstruction of justice).

54. *See* Louisiana State Bar Ass'n v. McSween, 347 So. 2d 1118 (La. 1977) (attorney suspended from practice for receiving funds from federally insured savings and loan association with intent to defraud); Attorney Grievance Comm'n v. Silk, 279 Md. 345, 369 A.2d 70 (1977) (attorney disbarred for misappropriating the funds of a club while serving as president and treasurer); State *ex rel* Neb. State Bar Ass'n v. Ledwith, 197 Neb. 572, 250 N.W.2d 230 (1977) (attorney disbarred for conversion of funds of estate for which he acted as both executor and attorney); *In re* Franklin, 71 N.J. 425, 365 A.2d 1361 (1976) (attorney suspended from practice for submitting fraudulent expenses on weekly reports to corporation of which he was president); *In re* Howe, 257 N.W.2d 420 (N.D. 1977) (attorney suspended from practice for deliberately giving false information to insurance and drivers license authorities); *In re* Stodd, 279 Or. 568, 563 P.2d 665 (1977) (attorney suspended from practice for converting to his own use fund entrusted to him as president of a nonprofit organization); *cf. In re* Conduct of Steffen, 279 Or. 313, 567 P.2d 544 (1977) (deceit of attorney who falsely represented to policeman that he was employed at the district attorney's office, although improper, did not merit reprimand). *See also In re* DuPre, 270 S.C. 264, 241 S.E.2d 896 (1978) (attorney disbarred for writing checks on a closed account in conjunction with other conduct related to practice of law).

55. *See In re* Conduct of Steffen, 279 Or. 313, 315, 567 P.2d 544, 545 (1977).

II. BANKS AND BANKING: THE ROLE OF THE FDIC

In *FDIC v. Godshall*,[56] defendant signed a promissory note issued by American Bank & Trust for $65,500. The bank was subsequently closed by the State Board of Bank Control, which had determined that American Bank & Trust (AB&T) was unable to meet the demands of its depositors. The FDIC, by virtue of its appointment by the State Board as receiver for the bank, became the holder of the note.[57] Performing its duties as receiver, the FDIC sold certain assets to Southern Bank & Trust in return for that bank's assumption of AB&T's liabilities. The FDIC also agreed to pay Southern Bank & Trust the difference between the value of assets purchased and the amount of liability assumed. To meet this obligation, the FDIC, in its capacity as receiver, sold to itself, in its general corporate capacity, the remainder of the assets of AB&T.[58]

Among the assets sold was defendant's note. The FDIC sought to collect it, bringing suit in the United States District Court for the District of South Carolina. Defendant did not deny his liability on the note, but challenged the subject matter jurisdiction of the court under a provision of the Federal Deposit Insurance Act,[59] which reads in pertinent part:

> All suits of a civil nature at common law or in equity to which the Corporation shall be a party shall be deemed to arise under the laws of the United States . . . except that any such suit to which the Corporation is a party in its capacity as receiver of a State bank and which involves only the rights or obligations of depositors, creditors, stockholders, and such State bank under

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56. 558 F.2d 220 (4th Cir. 1977).

57. S.C. CODE ANN. § 34-3-630 (1976) provides:

> The Federal Deposit Insurance Corporation may, with the approval of the State Board of Bank Control, be and act without bond as receiver or liquidator of any banking institution the deposits in which are to any extent insured by the Corporation and which shall have been closed on account of inability to meet the demands of its depositors.
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> The State Board of Bank Control may, in the event of such closing, tender to the Corporation the appointment as receiver or liquidator of such banking institution and, if the Corporation accepts such appointment, it shall have all the powers and privileges provided by the laws of this State with respect to a receiver or liquidator of a banking institution, its depositors and other creditors and be subject to all the duties of such receiver or liquidator.

58. The FDIC, pursuant to 12 U.S.C. § 1823(d) (1975), may purchase from the receiver the assets of a closed state bank that it insures if the sale is approved by appropriate state authority. In this instance the receiver was the FDIC. See note 57 *supra*.

59. 12 U.S.C. § 1811-1831 (1975).

> State law shall not be deemed to arise under the laws of the United States.[60]

The first assertion in defendant's twofold argument against the jurisdiction of the district court was that the FDIC, by merely changing hats upon selling itself its own assets, had not truly changed its character from that of receiver and retained receiver status in its claim before the court. Defendant's second assertion was that the claim raised legal issues that pertained solely to the rights and obligations of AB&T's depositors, creditors, or stockholders under state law, and, therefore, the claim should "not be deemed to arise under the laws of the United States."[61]

The Fourth Circuit Court of Appeals rejected both arguments. Against the first, the court noted that in *Freeling v. Sebring,*[62] the Tenth Circuit held that the FDIC may act simultaneously in its corporate capacity and its receivership capacity. Moreover, the court observed that excess recovery on the sold assets was to go to the FDIC's corporate treasury and not the receivership estate. Against defendant's second argument, the court noted that the bank's depositors, creditors, and stockholders were not the only parties whose rights and obligations the suit affected. Rather, the FDIC would absorb almost the entire financial impact of the suit, whether successful or unsuccessful. The FDIC's loss of the suit would not affect the depositors, creditors, and shareholders. Only if the FDIC won would these parties benefit, and then only if the aggregate recoveries exceeded the liabilities of the bank. Consequently, the Fourth Circuit found no merit in defendant's jurisdictional challenge and upheld the district court's judgment for the FDIC.[63]

The court observed in a footnote in *Godshall* that a Michigan district court came to the opposite conclusion on defendant's first argument.[64] That case, *FDIC v. Ashley,*[65] was quite similar to *Godshall,* and the court held that the FDIC continued to act as

60. *Id.* § 1819.

61. *Id.*

62. 296 F.2d 244 (10th Cir. 1961). This case held that federal jurisdiction was not invoked when appellant sued to recover a deposit basing his claim on the failure of the FDIC to comply with state law. There was no question of FDIC as receiver selling assets to itself as a corporation, and apparently no one contested whether the FDIC as liquidating agent committed the acts complained of. The court found this to be precisely within the protection of 12 U.S.C. § 1819.

63. 558 F.2d at 223.

64. *Id.* at n.8.

65. 408 F. Supp. 591 (E.D. Mich. 1976).

receiver after it assigned assets to itself. According to that court, the assignment facilitated the collection of outstanding debts and the liquidation of assets, which is traditionally the job of the receiver. The court stated:

> If one looks to the substance of the transactions in the instant case rather than to their form, it is clear that the FDIC proper is performing a receiver's obligation when it sues on claims alleged here. In 12 U.S.C. § 1819, Congress has clearly expressed its intent that in performing the function of receiver of a state bank the FDIC should use the state courts.[66]

The *Ashley* rationale did not impress the Fourth Circuit. Because of the *Freeling* holding that the FDIC may function in two capacities, the assertion that the FDIC in its corporate capacity must be held to jurisdictional limitations placed on the FDIC as receiver is anomalous.[67] In *Ashley* the court apparently had insisted on viewing the FDIC as a single entity in the transaction and expressed a fear that, viewed otherwise, the FDIC, as a part of the executive branch, could confer jurisdiction which Congress did not intend on the federal courts, by simply making assignments.[68]

Other federal district courts have rejected the *Ashley* approach to the FDIC's sales to itself of corporate assets. In *FDIC v. Design & Development Inc.*,[69] the federal district court of Wisconsin looked to the Federal Deposit Insurance Act[70] and held that it contemplates the receiver and the corporation as distinct entities.[71] In *FDIC v. Abraham*,[72] the federal district court of Louisiana found, in a situation similar to *Godshall*, that merely because some of the corporate FDIC's actions were similar to those of a receiver, they did not deprive the court of jurisdiction over the corporation.[73] In addition, that court found in the United States Code an alternative jurisdictional basis for the FDIC.[74] Section 1345 of title 28 gives original jurisdiction to district courts

66. *Id.* at 598.

67. *Freeling*, however, presented a more obvious case for federal jurisdiction because it involved a suit by a depositor against the FDIC for the insured part of his deposits. 296 F.2d at 246. The *Ashley* court distinguishes *Freeling* on that basis. 408 F. Supp. at 596.

68. 408 F. Supp. at 598.

69. 73 F.R.D. 442 (E.D. Wis. 1977).

70. 12 U.S.C. §§ 1811-1831 (1975).

71. 73 F.R.D. at 444.

72. 439 F. Supp. 1150 (D. La. 1977).

73. *Id.* at 1152-53.

74. *Id.* at 1154-55.

in proceedings commenced by the United States or by agencies authorized to sue by act of Congress.[75] This hitherto largely uncharted path into federal courts will doubtlessly facilitate the FDIC's function as deposit insurer. Cases such as *Godshall* and *Abraham* have probably invalidated jurisdictional defenses against the corporate FDIC, or at least those based on the proposition that the FDIC continues to act as receiver when it sues on bills, notes, choses of action, or other assets that it has sold to itself in its corporate capacity.

On the same day it decided *Godshall,* the Fourth Circuit, in an opinion also written by Judge Winter, decided another case arising from the closing and receivership of American Bank & Trust, *FDIC v. American Bank & Trust Shares, Inc.*[76] Among the assets that the FDIC as receiver sold itself in its general corporate capacity were certain choses in action, including claims against the directors and officers of AB&T for acts of misfeasance and nonfeasance harming the bank. The FDIC, in its general corporate capacity, instituted this suit against American Bank & Trust Shares, Inc., the parent company of AB&T. The FDIC asked for a declaratory judgment that it was the sole owner of the causes of action.

At the time of the initiation of this suit, and shortly thereafter, a number of the shareholders of American Bank & Trust Shares instituted derivative actions against the directors and officers of both AB&T and the parent company. The United States District Court for the District of South Carolina enjoined these suits and made the shareholders parties defendant in the declaratory judgment action.[77] The district court held, *inter alia,* that the shareholders owned the causes of action that were based on federal securities law violations, except for claims based on section 16(b) of the Securities Exchange Act of 1934.[78] All other claims, particularly those based on losses suffered by the bank because of the mismanagement and negligence of its officers and directors, were held to belong to the bank itself, not to the shareholders. Hence, the FDIC in its corporate capacity had acquired all rights to these actions.[79]

75. 28 U.S.C. § 1345 (1976).
76. 558 F.2d 711 (4th Cir. 1977).
77. FDIC v. American Bank & Trust Shares, Inc., 412 F. Supp. (D.S.C. 1976).
78. *Id.* at 308. Section 16(b) is codified at 15 U.S.C. § 78p(b) (1976).
79. 412 F. Supp. 302, 308 (D.S.C. 1976).

The district court also noted that the counterclaims that the shareholders asserted were nonderivative. The shareholders claimed that the board of directors had committed fraud by inducing them to purchase capital notes and that FDIC had done so by inducing the State Banking Control Board to appoint it as receiver. The shareholders further claimed that the South Carolina statutes allowing the FDIC to be appointed receiver and allowing the acquisition of the assets were unconstitutional. These counterclaims, however, were held to be subordinate to the claims of the corporate FDIC for harm done to the bank and to the claims of general creditors, in whose place the FDIC now stood.[80] The court, therefore, held that all shareholder claims should be held in abeyance until further order[81] — apparently until after the FDIC settled its claims against the officers and directors.

On appeal, the Fourth Circuit reversed the holding of the district court that the shareholders' counterclaims should await the disposition of the FDIC's claims against the bank's officers and directors.[82] The Fourth Circuit agreed with the district court that the FDIC acquired apparent title to the choses in action, but because proving these counterclaims would divest this title, there was no certainty that the FDIC was the sole owner of the choses until the counterclaims were adjudicated.[83]

In upholding the district court's determination that the causes of action under section 16(b) of the Securities Exchange Act of 1934 were not owned by the shareholders, the court noted that while such actions are not derivative for purposes of the Federal Rules of Civil Procedure,[84] section 16(b) provides that the initial opportunity to sue for the recovery of inside profits belongs to the corporation, that is, the bank. Because the FDIC now owned the bank's rights, the shareholders could bring suit only if the FDIC declined to do so.[85]

III. Mechanic's Liens — Lis Pendens

In *Multiplex Building Corp., Inc. v. Lyles,*[86] respondent Mul-

80. *Id.* at 309.
81. *Id.*
82. 558 F.2d at 715.
83. *Id.*
84. *See* Fed. R. Civ. P. 23(b).
85. 558 F.2d at 716.
86. 268 S.C. 577, 235 S.E.2d 133 (1977).

tiplex sought to foreclose a mechanic's lien that it had previously filed against appellant within the statutory six-month period.[87] Respondent had never filed a notice of pendency on the lien; and Appellant sought to dissolve the lien because he believed the failure to file the notice of pendency barred the lien's enforcement.[88] The trial court, following the findings of the master in equity, refused to dissolve the lien, holding that the purpose of the notice requirement was to give notice to purchasers or encumbrancers. Appellant Lyles, who was a party to the action with actual notice and who had not been damaged by the failure to file, could not complain of the lack of notice since he had actual knowledge of the suit. On appeal, the supreme court held that the filing requirement could not be dispensed with under South Carolina law.

The issue in *Multiplex* is the importance of the requirement of the notice of pendency, or *lis pendens,* as applied to mechanic's lien cases. Mechanic's liens are creatures of statute[89] and the mechanic's lien statutes vary widely from jurisdiction to jurisdiction.[90] In some states, courts have held that mechanic's lien statutes should be strictly construed and their requirements strictly enforced, because the statutes are in derogation of the common law.[91] Other courts have held that the statutes should be given a liberal construction,[92] at least after the lien attaches,[93] so that the statutes might not fail of their essential purpose, which is the

87. *See* S.C. CODE ANN. §§ 29-5-10, -120 (1976).

88. *Id.* § 29-5-120 provides in pertinent part: "Unless a suit for enforcing the lien is commenced, and notice of pendency of the action is filed, within six months after the person desiring to avail himself thereof ceases to labor or furnish labor or material for such building or structures, the lien shall be dissolved." *Id.*

89. *See, e.g.,* Springer Land Ass'n. v. Ford, 168 U.S. 513 (1897); Waters v. Dixie Lumber & Mfg. Co., 106 Ga. 592, 32 S.E. 636 (1899); Freeform Pools, Inc. v. Strawbridge Home for Boys, 228 Md. 297, 179 A.2d 683 (1962); Cain v. Rea, 159 Va. 446, 166 S.E. 478 (1932).

90. See generally Note, *Burton Drywall, Inc. v. Kaufman, Pre-Lien Notice Requirements: An Exception?,* 1977 DET. C.L. REV. 725, 728-29 (1977).

91. *See, e.g.,* Partin v. Konsler Steel Co., 336 So. 2d 684 (Fla. Dist. Ct. App. 1976); Cowherd & Sanderlin v. Modern Improvement Co., Inc., 142 So. 2d 786 (Fla. Dist. Ct. App. 1962); Freeform Pools, Inc. v. Strawbridge Home for Boys, 228 Md. 297, 179 A.2d 683 (1962); Cox v. Hruza, 54 N.J. Super. 54, 148 A.2d 193 (1959); Glass v. Stark, 156 Wis. 21, 145 N.W. 236 (1914).

92. *See, e.g.,* Packard Bell Elec. Corp. v. Theseus, Inc., 244 Cal. App. 2d 355, 53 Cal. Rptr. 300 (1966); Empire Land & Canal Co. v. Engley, 18 Colo. 388, 33 P. 153 (1893); Kettles v. Charter Mortgage Co., 337 So. 2d 1012 (Fla. Dist. Ct. App. 1976).

93. *See, e.g.,* Burton Drywall, Inc. v. Kaufman, 69 Mich. App. 85, 244 N.W.2d 367 (1976), *rev'd on other grounds,* 402 Mich. 366, 263 N.W.2d 249 (1978); Wallich Lumber Co. v. Golds, 375 Mich. 323, 134 N.W.2d 722 (1965).

protection of the interests materialmen and laborers have in the value of materials furnished or services rendered by them.

In *Multiplex* respondent insisted that South Carolina Code section 29-5-120,[94] requiring the filing of both a suit for the enforcement of the lien and notice of pendency, should not be strictly construed. Respondent argued that the statute should be read in light of the purpose of the *lis pendens* requirement, which is notifying innocent buyers or encumbrancers, and that this purpose was satisfied because appellant, as a party to the action, had actual notice.[95] Attempting to frame the case as one of unjust enrichment, respondent asserted that the mechanic's lien itself was designed to protect mechanics and materialmen from the default of persons to whom they had rendered valuable services.[96]

Both parties cited a 1966 South Carolina Supreme Court case, *Jones v. South Carolina State Highway Department,*[97] to support their arguments. That case concerned the construction of a reckless driving statute. Respondent cited language stating that statutes should be given constructions consistent with their policy objectives.[98] Appellant, however, cited language in the same paragraph of the opinion that said that literal constructions should be adhered to if the statute is unambiguous.[99]

In finding for appellant, the South Carolina Supreme Court seems to have taken a more landowner-oriented position on the *lis pendens* requirement than have most jurisdictions. In view of the policy goal behind liberal construction of the mechanic's lien statutes, protecting suppliers of labor and materials, some courts have held that purchasers or encumbrancers chargeable with con-

94. S.C. CODE ANN. § 29-5-120 (1976).

95. Brief for Appellant at 3, 4, Multiplex Bldg. Corp. v. Lyles, 268 S.C. 577, 235 S.E.2d 133 (1977).

96. Brief for Respondent at 5, 6, Multiplex Bldg. Corp. v. Lyles, 268 S.C. 577, 235 S.E.2d 133 (1977). Respondent particularly noted the language of General Air Conditioning Corp. v. Stuewe, 156 Kan. 182, 131 P.2d 638 (1942): "In our discussion we take note of the rule that the mechanic's lien law is not to be strictly construed because in supposed derogation of the common law." *Id.* at 184, 131 P.2d at 639. That case, however, concerned the failure to file a lien statement as opposed to *lis pendens.* Respondent also quoted Trane Co. v. Wortham, 428 S.W.2d 417 (Tex. Civ. App. 1968): "It is a rule of long standing that mechanic's and materialmen's lien statutes of this state will be liberally construed for the purposes of protecting laborers and materialmen." *Id.* at 419. That case was brought on the issue of the validity of the assignment of a lienor's benefits.

97. 247 S.C. 132, 146 S.E.2d 166 (1966).

98. Brief for Respondent at 6, Multiplex Bldg. Corp. v. Lyles, 268 S.C. 577, 235 S.E.2d 133 (1977).

99. Brief for Appellant at 2, Multiplex Bldg. Corp. v. Lyles, 268 S.C. 577, 235 S.E.2d 133 (1977).

structive notice of liens may not avail themselves of a failure by the lien-holder to file notice of pendency.[100] Constructive notice might be inferred from the existence of the suit for foreclosure of the lien,[101] or, at least in one case, from the mechanic's lien statute itself and its notice requirements.[102] Substantial authority exists for holding that notice of pendency or other notice is not required when a party has actual knowledge of the lien.[103] One judge noted that to hold otherwise would be to exalt constructive notice over actual notice.[104] Michigan has developed a "direct dealing exception": one dealing directly with the owner of property need not give notice.[105] Only two other states, New York[106] and Florida,[107] have authority requiring notice of pendency to be timely filed before relief may be granted under the mechanic's lien statute against a property owner with actual notice of the lien. In New York the notice of pendency is regarded as a jurisdictional prerequisite for relief.[108]

The supreme court, in finding for appellant and dissolving the lien, construed the statute in a manner that seems to have produced a harsh result. Respondent, however, is not without a contractual damage remedy.[109] In addition, the supreme court's decision simply upheld the apparent legislative intent to keep tight statutory control on the imposition of mechanic's liens.[110]

100. Sax v. Clark, 180 Cal. 287, 180 P. 821 (1919); Empire Land & Canal Co. v. Engley, 18 Colo. 388, 33 P. 153 (1893); Washtenaw Lumber Co. v. Belding, 233 Mich. 608, 208 N.W. 152 (1926).

101. Sax v. Clark, 180 Cal. 287, 180 P. 821 (1919).

102. Empire Land & Canal Co. v. Engley, 18 Colo. 388, 33 P. 153 (1893).

103. Packard Bell Elec. Corp. v. Theseus Inc., 244 Cal. App. 2d 335, 53 Cal. Rptr. 300 (1966); Wallich Lumber Co. v. Golds, 375 Mich. 323, 134 N.W.2d 722 (1965).

104. Wallich Lumber Co. v. Golds, 375 Mich. 323, 326, 134 N.W.2d 722, 724 (1965).

105. *Id.* at 327, 134 N.W.2d at 725.

106. Siracusa v. Inch Corp., 164 Misc. 820, 298 N.Y.S. 878 (1937); Johnson v. Waldo Griffiths, Inc., 144 Misc. 773, 259 N.Y.S. 386 (1932).

107. Adams v. Kenson Supply Co., 137 So. 2d 27 (Fla. Dist. Ct. App. 1962); Cowherd & Sanderlin, Inc. v. Modern Improvement Co., 142 So. 2d 786 (Fla. Dist. Ct. App. 1962); Trushin v. Brown, 132 So. 2d 357 (Fla. Dist. Ct. App. 1961).

108. *See* Siracusa v. Inch Corp., 164 Misc. 820, 298 N.Y.S. 878 (1937); Johnson v. Waldo Griffiths, Inc., 144 Misc. 773, 259 N.Y.S. 386 (1932).

109. Brief for Appellant at 13, Multiplex Bldg. Corp. v. Lyles, 268 S.C. 577, 235 S.E.2d 133 (1977).

110. Apparently without consideration of whom the requirement benefitted, the South Carolina General Assembly amended § 45-262 of the 1952 code to impose the *lis pendens* requirement in its present form, No. 167, 1957 S.C. Acts 181. One commentator notes that the South Carolina mechanic's lien laws more or less stack the deck in favor of the property owner to the detriment of contractors and mechanics. *See generally,* Note, *Mechanic's Liens in South Carolina,* 25 S.C.L. Rev. 817, 854-61 (1974).

The court quoted a Florida case, *Trushin v. Brown,*[111] in which the same issue was considered:

> Although the wisdom of the requirement in all mechanic's lien foreclosures for the filing of a notice of the pendency of an action, where the rights of third parties are not involved, may be questionable, nevertheless we feel it our duty to construe the statute in the light of its clear and unambiguous terms.[112]

The mechanic's lien is itself an extraordinary remedy. It is an *in rem* right that not only encumbers the sale of realty, but can also subject realty to sale for settlement of a contractual claim. In that respect, the lien is somewhat like a mortgage arising from the rendering of services.[113] Because of the nature of the remedy, the requirement of strict adherence to statutory requirements may well be justified.

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111. 132 So. 2d 357 (Fla. Dist. Ct. App. 1961).

112. *Id.* at 359.

113. 10 G. THOMPSON, COMMENTARIES ON THE MODERN LAW OF REAL PROPERTY, § 5186 (Repl. Vol. 1957).